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## **W.R. Berkley Corp. And Operating Subsidiaries**

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### **Major Rating Factors**

**Strengths:**

- Very strong underwriting performance.
- Strong, well-diversified competitive position.
- Strong liquidity.

**Weaknesses:**

- Somewhat aggressive historical financial leverage at the holding company.
- Operating company capital levels that are supportive of

**Holding Company:**

**W.R. Berkley Corp.**

**Counterparty Credit Rating**

*Local Currency*  
BBB+/Stable/--

**Operating Companies Covered By This Report**

**Financial Strength Rating**

*Local Currency*

## Rationale

The counterparty credit rating on W.R. Berkley Corp. and the insurer financial strength ratings on its operating insurance companies (collectively referred to as WRB) reflect WRB's consistently very strong underwriting performance; strong, well-diversified competitive position; and strong liquidity. Offsetting these strengths are WRB's somewhat aggressive historical financial leverage and operating company capital levels that, though currently strong, might be pressured in the growth phase of the underwriting cycle.

WRB's consistent track record of very strong underwriting performance is the core strength to the rating, as evidenced by combined ratios of 93% in 2008, 88% in 2007, 88% in 2006, 89% in 2005, and 90% in 2004. Given a claims duration exceeding three years, Standard & Poor's Ratings Services views these results as very strong and above the rating level.

WRB's competitive position is strong, based on its well-diversified revenue profile, long-standing relationships with producers, economies of scale, and market position. WRB has a highly diversified competitive profile, with operations in five segments of the property/casualty (P/C) market: specialty lines (excess and surplus and specialty admitted lines), regional (commercial P/C), alternative markets (fee-based and workers' compensation), reinsurance, and international.

Liquidity is strong, supported by high-quality fixed maturities and cash equivalents constituting 87% of the investment portfolio as of June 30, 2009. The average credit quality of the bond portfolio is 'AA', with an average duration of three years. Notwithstanding WRB's \$224 million of realized losses and investment fund losses in the first six months of 2009, WRB's overall portfolio is sound, as evidenced by a net unrealized gain of \$79 million as of June 30, 2009, on a fixed maturity portfolio of \$10.4 billion. These liquid assets, relative to \$9.1 billion of loss reserves with a duration in excess of three years and very limited catastrophe exposure, underlie WRB's strong liquidity profile.

Berkley is an aggressive, though prudent, manager of capital. Although current capitalization is strong, WRB has a track record of temporarily stressing capital to levels below the rating when market conditions are favorable for pursuing rapid growth, such as in 2003 and 2004 when capital fell below the rating level while WRB generated growth rates that peaked at 35% in 2003. At the same time, financial leverage at the holding company was high for the rating, with total leverage of 36%-38% during the three years ended December 2005. Although total financial leverage (32% as of June 30, 2009) is consistent with the rating, debt leverage (26%) is above our criteria threshold of 20%, with the excess leverage deducted in our assessment of capitalization. We believe WRB might continue to moderately stress capital and financial leverage as it pursues growth opportunities, particularly when the underwriting cycle becomes more favorable.

## Factors Specific To Holding Company

Standard & Poor's applies standard notching (one full category) between the ratings on the operating companies and the rating on the holding company, W.R. Berkley. The three notch difference reflects the holding company's dependence on dividends from its operating subsidiaries and regulators' ability to prohibit those dividends. As of year-end 2008, dividends available from the subsidiaries to W.R. Berkley without prior regulatory approval totaled \$392 million.

of the outstanding debt are \$150 million in 2010, \$1 million in 2011, \$3 million in 2012, \$200 million in 2013, \$200 million in 2015, \$150 million in 2019, \$77 million in 2022, \$7 million in 2035, \$250 million in 2037, and \$250 million in 2045.

Holding company financial metrics are consistent with the rating, with debt leverage of 26% and intermediate hybrid equity leverage of 6% as of June 2009. W.R. Berkley exceeds our debt double-leverage tolerance by \$181 million. Consistent with our criteria, we reduce our view of capital at the operating company level by this amount. Even with this adjustment, we view operating company capitalization as strong as of June 2009. W.R. Berkley's fixed-charge coverage ratio, excluding realized gains/losses, of 8.4x in 2008, though slightly lower than 12x in 2007 and 11x in 2006, is extremely strong and consistent with our expectations. Although adverse pricing conditions likely will result in lower earnings and coverage metrics in the next one to two years, we expect fixed-charge coverage to remain a strength to the rating.

Notwithstanding current metrics, the company has a track record of stressing financial leverage to pursue growth opportunities, as evidenced by total financial leverage exceeding 35% at the height of the favorable market cycle in 2005. W.R. Berkley has a history of pursuing somewhat aggressive financial tolerances in times of favorable market conditions. Although these periods of elevated financial leverage were ultimately addressed by the retention of earnings, Standard & Poor's views this as a moderate strain on financial flexibility, particularly if the company were to experience an unexpected and materially adverse event to its operations at a time of somewhat aggressive financial metrics.

**Table 1** | [Download Table](#)

W.R. Berkley Corp. Financial Statistics					
	–Six months ended June 30–		–Year ended Dec. 31–		
	2009	2008	2007	2006	2005
GAAP interest coverage (EBIT) (x)	4.9	10.3	14.7	13.3	12.7
GAAP fixed-charge coverage (EBIT) (x)	4.0	8.4	12.0	11.0	9.3
Statutory interest coverage (x)	N.A.	4.1	6.8	3.0	3.4
Statutory fixed-charge coverage (x)	N.A.	3.4	5.6	2.5	2.5
Debt leverage (%)	25.7	26.3	23.3	21.5	26.2
Hybrid leverage (%)	5.9	5.9	4.8	5.6	11.5
Financial leverage (%)	31.6	32.2	28.1	27.1	37.7

N.A.—Not available.

**Chart 1** | [Download Chart Data](#)

**Chart 2** | [Download Chart Data](#)

## Outlook

The outlook is stable because the consistently very strong earnings from the solidly positioned, diversified subsidiaries offset WRB's modestly aggressive financial profile. An adverse change to WRB's very strong earnings profile or a diminished view of its enterprise risk management (ERM) at the operating company level could result in an outlook revision to negative. Alternatively, we could revise the outlook to positive if WRB, while sustaining its very strong earnings profile, improves its ERM to the strong level and demonstrates a consistent track record of capitalization and financial leverage more appropriate for a higher rating.

Standard & Poor's capital adequacy ratio at the operating company level will remain strong, with holding company financial leverage, excluding proceeds earmarked to retire future debt obligations, of less than 35%. Although we expect difficult market conditions to pressure WRB's top-line and bottom-line operating performance, the company will sustain very strong operating performance, with a combined ratio of less than 96% (very strong for this stage of the insurance cycle) and fixed-charge coverage, excluding realized investment gain/losses and investment fund losses, exceeding 8x.

## Competitive Position: Posting Very Strong Operating Results And Maintaining Well-Diversified Business

WRB's competitive position is strong, based on its well-diversified revenue profile, long-standing relationships with producers, and economies of scale, as demonstrated by \$4.5 billion of gross premiums written (GPW) in 2008. WRB is well diversified by business segment, line of business within each segment, and distribution. WRB's low reliance on reinsurance (10% reinsurance utilization ratio) is an additional positive to the rating.

WRB's consistent track record of booking very strong underwriting results demonstrates its competitive strength. WRB's well-performing specialty and regional segments (\$3 billion gross premium) underpin its competitive position. With the exception of weather-related losses hurting regional sector profitability in 2008 (98% combined ratio), both segments reported combined ratios of less than 91% in each year since 2001.

WRB continues to bolster its business profile by establishing new specialty underwriting units with the goal of capitalizing on future growth opportunities borne from the next favorable underwriting cycle as well as capitalizing on underwriting talent displaced from struggling competitors.

Table 2 | [Download Table](#)

W.R. Berkley Corp.'s Operating Companies/Business Statistics					
	-Six months ended June 30-		-Year ended Dec. 31-		
(Mil. \$)	2009	2008	2007	2006	2005
Gross premiums written	2,202.8	4,520.1	5,053.2	5,277.0	5,088.0
Year-over-year change (%)	(8.2)	(10.5)	(4.2)	3.7	7.7
Net premiums written	1,932.4	4,033.9	4,576.0	4,819.0	4,604.6

Reinsurance utilization (%)	12.3	10.8	9.4	8.7	9.5
<b>Net premiums by line of business</b>					
Specialty insurance (%)	34.2	36.1	37.3	37.7	39.8
Alternative markets (%)	16.8	15.4	14.3	13.5	14.5
Reinsurance (%)	10.8	10.8	14.9	18.5	15.6
Regional (%)	29.0	30.0	27.7	25.6	26.0
International (%)	9.2	7.7	5.8	4.7	4.1

### Specialty segment

The specialty segment (35% of GPW in 2008) has a strong competitive position based on its contribution within the excess and surplus lines and admitted specialty markets (\$1.6 billion of gross written premium in 2007), specialized products, and long-term relationships with its distributors. Although this business is highly competitive, with gross premium volumes declining by more than 12% in 2008 and 8% during the six months ended June 30, 2009, Berkley has a well-established competitive position in this segment and continues to realize very strong, industry-leading margins while sustaining a strong market presence.

Berkley conducts its specialty business through fifteen operating units focusing on different customer bases and product offerings.

Admiral Insurance Co. (24% of segment GPW in 2008) provides excess and surplus lines coverage in the commercial general liability, professional liability, commercial property, and commercial excess and umbrella liability lines of business. Distribution for these relatively complex and high-risk products is through wholesale brokers to middle-market commercial accounts.

Nautilus Insurance Co. (18% of GPW in the segment) markets similar products but targets less complex risk (less than \$5,000 average premium) from significantly smaller clients. Unlike Admiral, Nautilus business is written on a binding authority basis, or individually underwritten wholesale broker business.

Berkley Specialty (10% of GPW in the segment) underwrites general liability coverage, with an emphasis on products liability. It also underwrites P/C insurance products, both on an admitted and nonadmitted basis, for the entertainment industry and sports-related organizations. The environmental division underwrites specialty insurance products to environmental customers such as contractors, consultants, and owners of sites and facilities.

Carolina Casualty Insurance Co. (10% of 2008 specialty segment GPW) specializes in transportation insurance for intermediate- and long-haul trucking, as well as various classes of business and public auto risks. In early 2009, a new division, Gemini Transportation Underwriters, was formed to offer excess liability and railroad protection. The Carolina Casualty business is split between general agent and brokerage channels.

management liability, nonprofit directors and officers liability, and accountants' preferred liability.

The remaining specialty operating units (29% of the segment's GPW) pursue similarly focused specialty business in the U.S. On a GPW basis, premises operations constituted 33% of 2008 consolidated specialty business, with commercial auto (16%), commercial property (15%), professional liability (13%), product liability (10%), and other (13%) rounding out the book of business.

### **Regional segment**

The regional segment's (31% of 2008 consolidated GPW) competitive position is strong, based on its position within commercial lines, providing products to Berkley's customers primarily in 48 states and the District of Columbia. Leveraging solid agency relationships and a commitment to customer focus, the regional segment has countered larger competitors, as evidenced by this segment's minor 4% decline in GPW in 2008. However, heightened price competition, particularly in the large account segment, resulted in gross production declines of 13.5% during the first six months of 2009. The specific target market of WRB's regional platforms is small to midsize businesses and governmental entities. Business is well diversified by state, with the top five states--Massachusetts (6.8%), Texas (6.7%), Kansas (5.8%), Pennsylvania (5.7%), and New Hampshire (4.9%)--constituting 30% of direct premium volume in 2008. The next five states contributed an additional 20% of total writings. Commercial multiperil constituted 34% of total business by line in 2008, with commercial auto (26%), workers' compensation (18%), assigned risk plans (6%), and other lines (16%) rounding out the book of business.

### **Alternative segment**

The alternative segment (16% of 2008 consolidated GPW) provides a variety of fee-based (consulting and administrative) services and risk-transfer mechanisms. Midwest Employers Casualty Co. (44% of 2008 gross segment premiums) provides excess workers' compensation to self-insured employers and groups above their self-insured or retention limits. Preferred Employers Insurance Co. (9%) offers primary workers' compensation to owner-managed small employers in California. Berkley Risk Administrators (10%) is a nationwide third-party administrator of P/C insurance claims, policy, and underwriting services. Key Risk Insurance Co. (20%) offers primary workers' compensation principally in North Carolina.

Two relatively new units, BerkleyNet and Berkley Accident and Health, contributed 10% of segment productions. BerkleyNet (5%) utilizes a Web-based platform to efficiently quote, bind, and service workers' compensation products for small- and medium-size commercial risks. Berkley Accident and Health (5%) participates in the medical stop-loss marketplace. Although overall premium production of these two fairly new units was modest (less than \$100 million) relative to WRB's total book of business, they demonstrate WRB's growth strategy of establishing teams of underwriters focused on specialty offerings.

### **Reinsurance segment**

Like its primary operations, WRB's reinsurance operations (10% of 2008 consolidated GPW) focus on specialty lines of business, offering reinsurance on an individual basis primarily through facultative reinsurance, as well as treaty reinsurance. The segment writes the majority of its business on behalf of Berkley Insurance Co. (BIC). The reinsurance business originates primarily from brokers, and its long-term relationships have resulted in an ability to implement a very specialized, customer-focused strategy. Similar to the specialty segments, the reinsurance operations consist of seven underwriting units specializing in various subsegments of the reinsurance market. Signet Star (53% of total GPW) focuses on casualty excess-of-loss treaties produced through reinsurance brokers and intermediaries. Facultative ReSources Inc. (22%) specializes in individual certificate and program facultative business produced through brokers. BF Re (12%) is a direct casualty facultative reinsurance underwriting

some catastrophe-exposed property) through a Lloyd's syndicate. In 2008, the reinsurance business had an 83%/17% split between casualty and property.

### **International segment**

Berkley's international segment (8% of 2008 consolidated GPW) has operations in Europe (mainly the U.K. and Spain), South America, Asia, and Australia. Berkley writes about \$160 million of casualty business in Europe, primarily professional lines. The company continues to demonstrate a commitment to growing its international books of business. The goal is to establish these operations in the current competitive market and realize growth when market opportunities present themselves. In addition to a solid presence in the U.K. through W.R. Berkley Insurance (Europe), the company has established a South America presence, as evidenced by its position as the 10th-largest P/C insurer in Argentina. In addition, Berkley maintains reinsurance branches in Hong Kong and Australia.

### **Prospective**

Notwithstanding premium declines borne from disciplined underwriting amid highly competitive pricing, Berkley's competitive position will remain strong, as evidenced by very strong profitability, while the company maintains scale. Over the short term, we expect consolidated net premiums to decline in the midsingle digits, stemming primarily from material declines in the specialty and regional segments. These segments have been hurt most by competitive pricing pressures, consistent with the current soft stage of the industry underwriting cycle. Just as WRB's continued underwriting discipline resulted in double-digit volume declines in the soft market of 2008 and 2009, in times of favorable conditions (which might occur in 2010 and 2011), premium volume could increase in the double digits to the low-20% area, depending on how favorable market conditions are. Standard & Poor's notes that during the height of the last favorable pricing cycle in 2005, WRB's premium volume increased by 35%.

## **Management And Corporate Strategy: Providing A Stable Return From The Diversified Insurance Operations To Its Stockholders**

W.R. Berkley's corporate strategy focuses on providing a stable return to its stockholders through its diversified insurance operations. The consolidated group's corporate strategy is well executed (as measured by its very strong diversified underwriting performance), but WRB manages aggressive financial leverage and operating company capitalization in times of business opportunities. During the height of the favorable market cycle in 2003-2005, when WRB aggressively and profitably grew its business, financial leverage was well in excess of 30%. At the same time, capital at the operating company level, though strong, was below the rating level. Notwithstanding WRB's very strong and consistent earnings profile, the company's willingness to aggressively pursue business opportunities through a somewhat aggressive capital and financial leverage structure increases risk, particularly if an unforeseen loss occurs.

Berkley's senior managers have substantial industry experience. The chairman and founder, William Berkley, created the company in 1967. Using a decentralized management structure, presidents operate the various insurance entities, which function as underwriting units, with oversight from the segment senior vice presidents based at the home office. The corporate strategy is to seek specialized product areas or geographic regions where the insurance subsidiaries can gain a competitive advantage through knowledge-based underwriting and by responding quickly to changing market conditions. Each subsidiary establishes its own pricing practices, which the parent company monitors. The successful execution of this is a testament to the company's operational management.

Standard & Poor's recognizes WRB's very strong historical track record of solid performance. The

senior vice presidents and individual operating company presidents throughout the organization. In the face of the next favorable underwriting cycle and the strong growth generated by current and material production from newer start-up operations, WRB faces the challenge of sustaining and institutionalizing this culture through a more formal ERM process.

## **Enterprise Risk Management: Favorable Underwriting, With A Focus On The Risks And Exposures It Knows Best**

We view W.R. Berkley's ERM as adequate with strong risk controls. The company's strong risk-management culture and strong insurance-risk controls, as evidenced by the organization's favorable underwriting results, support our view. In general, we believe that the insurer will not experience losses outside of what is normal for its traditional risk areas.

Risk management is an integral concept to the company's CEO and its senior management, and it's ingrained throughout the organization. It is evident that ERM is an essential part of W.R. Berkley's management process and is well appreciated at all levels of the organization. The company is well grounded in sound underwriting fundamentals, with a focus on exposures in which it is most knowledgeable. Part of W.R. Berkley's risk strategy is to avoid catastrophe risk and to sidestep significant investment risks while concentrating its resources on profitable underwriting of a diversified array of casualty business. It is predominately a low-limit casualty business, which enables the company to minimize reliance on reinsurance.

Investment-related risk controls seem rather basic, but commensurate with the level of complexity of the investment portfolio. The company has chosen to take its risks on the insurance side while minimizing investment volatility.

Insurance exposures are managed to full maximum loss rather than a probable maximum loss. This conservative approach significantly limits dependencies on vendor models and follows a disciplined qualitative approach where sound judgment and experience drive most decisions. The organization is consistent and diligent in maintaining pricing adequacy and does not jump in and out of products or regions purely on speculation or for opportunistic reasons. The company maintains an extensive pricing and reserving actuarial staff. There is fluid communication among actuaries, claims staff, and underwriters.

Conservative judgment is encouraged for the reserving process. Reserving decisions are made on the operating-company level, but W.R. Berkley ensures consistency of methodologies and assumptions across the company via the peer-review process. Nevertheless, reserve adequacy remains a considerable source of uncertainty for the company, particularly if claim costs start to escalate. This high-inflation scenario could coincide with high interest rates, thus eroding the value of the investment portfolio. The company is contemplating this and other macroeconomic scenarios as part of its financial-planning and emerging risk-management process.

W.R. Berkley is a complex and growing enterprise. This might present an operational challenge if the organizational structure does not keep up with the complexity and growth.

To enhance its ERM and strategic decision making, the company recently introduced an internal capital model. Although the modeling efforts are still new and developing, over time they should contribute to a favorable balance of qualitative and quantitative understanding of all risks that the organization faces.

management, evidence of a fully implemented decision-making framework supported by the internal capital model and more evidence of a broad and diverse strategic risk-management structure that addresses the challenge of sustaining a strong risk-management culture derived from the CEO and the senior vice presidents. On the other hand, if the company's performance indicates that controls and mitigation efforts are not as robust as originally thought, this will adversely affect our view of the company's ERM.

## Accounting

W.R. Berkley is a publicly traded entity subject to SEC filings. In addition, its insurance company subsidiaries are required to file statutory statements. KPMG audited the GAAP consolidated balance sheets as of Dec. 31, 2008, 2007, and 2006, and the related consolidated income statement and changes in shareholders' equity and cash flows for the three years ended Dec. 31, 2007, and expressed an unqualified opinion. Standard & Poor's is unaware of any regulatory inquiry into W.R. Berkley's financial reporting. The company filed all financial statements, statutory and GAAP, on a timely basis.

In our assessment of W.R. Berkley's capital adequacy, we replace the company's tabular and nontabular discounting with our own measurement of discounting in calculating the company's audited statutory reserves. Because our capital adequacy ratio model includes a time value of money benefit to the company's surplus base, we made the adjustment to avoid giving double credit to capital. In addition, certain publicly traded investments, with the exception of ownership of holding company stocks that are classified as affiliated on Berkley's statutory statements, have been reclassified as unaffiliated common stock, and we have applied the related capital charge to our capital model. Furthermore, we reclassified certain workers' compensation excess premium and reserves in our capital calculation from the other liability occurrence line to reinsurance excess workers' compensation in order to more appropriately reflect the risk profile of these businesses.

## Operating Performance: Weakened In 2008, But Likely To Receive A Boost From Solid Underwriting Performance

Berkley's consistently very strong and diversified underwriting performance is at the top of its peer group and is a significant strength to the rating. Given the company's somewhat aggressive financial management for the rating, the operating performance is the primary supporting factor for the rating and outlook.

Table 3 | [Download Table](#)

### W.R. Berkley Corp.'s Operating Companies/Operating Statistics

(Mil. \$)	–Six months ended June 30–		–Year ended Dec. 31–		
	2009	2008	2007	2006	2005
Total revenue (excluding realized gains/losses)	2,181.6	5,065.7	5,538.7	5,385.2	4,979.6
Underwriting gain or loss	104.2	296.0	353.3	380.0	320.5
Pretax income (before minority interest and excluding realized	133.9	683.3	1,042.7	978.9	753.3

interest)					
Pretax operating return on revenue (%)	6.1	13.5	18.8	18.2	15.1
Pretax operating return on equity (%)	4.2	20.6	30.3	33.5	32.2
Loss ratio (%)	62.6	62.7	59.6	61.0	62.4
Expense ratio (%)	32.0	30.4	28.5	27.0	26.9
Combined ratio (%)	94.6	93.1	88.1	88.0	89.3
Net cash flow from operating activities	(9.2)	1,553.0	1,479.7	1,564.0	1,719.8
Net cash flow from investing activities	(358.2)	(614.6)	(1,047.5)	(1,165.4)	(2,355.8)
Net cash flow from financing activities	(37.7)	(663.3)	(244.2)	(342.7)	376.9

### Historical

At year-end 2008, WRB reported a decline in its pretax operating income to \$326 million from \$1.1 billion in 2007. The results were adversely affected by \$356 million of realized investment losses, heightened weather-related losses, and the softening of the insurance pricing that--in combination with continued underwriting discipline--led to a 12% decline in net premiums written to \$4.03 billion for calendar-year 2008. Underwriting performance was strong, as evidenced by a combined ratio of 93.1% in 2008.

Berkley's 2007 pretax income before minority interest of \$1.1 billion (combined ratio of 88% and a pretax ROR of 19%) marked the continuation of very strong performance from previous years, as evidenced by results in the previous three years. The company recorded \$989 million in pretax income, a combined ratio of 88%, and a pretax ROR of 18% in 2006 and combined ratios of 89% and 90% in 2005 and 2004, respectively.

### Current performance

Notwithstanding strong underwriting performance, as measured by a 95% combined ratio, pretax earnings in the first six months of 2009 (\$71 million versus \$360 million in the first six months of 2008) were negatively affected by \$153 million of investment fund losses and \$134 million of other-than-temporary investment impairments.

### Prospective

WRB's operating performance in 2009 will remain pressured by tough insurance market conditions and ongoing, though diminished, losses from the alternative investment portfolio relative to the first quarter of 2009 (\$378 million carrying value as of June 30, 2009). However, the company's solid underwriting performance, as evidenced by a combined ratio of less than 96%, will fuel positive operating performance, with a pretax ROR, excluding realized investment and alternative investment fund losses, exceeding 12%.

## Term, Aftertax Returns

We view investments and liquidity as strong, based on high-quality bonds contributing to strong liquidity.

Although WRB's fixed-income portfolio has weathered the financial turmoil with a net unrealized gain of \$79 million as of June 30, 2009, the company has absorbed losses on its preferred stock position (Fannie Mae and Freddie Mac) as well as its investment funds portfolio, which has a concentration in real estate investments. However, unlike many peers, these losses have been offset by operating performance. As of June 30, 2009, WRB's investment portfolio held \$299 million of common equity and \$378 million of investment funds. Both of these investments are held at fair market value.

As of June 30, 2009, the consolidated group allocated its investments as follows: fixed-income securities, 81%; cash and cash equivalents, 6%; merger arbitrage, 5%; and other investments, 8%. WRB manages the assets for all its subsidiaries with a focus on maximizing long-term, aftertax returns. The average credit quality of the bond portfolio is 'AA', with an average duration of slightly more than three years.

WRB's fixed maturity portfolio is focused predominately on state and municipal holdings (57% as of March 31, 2009), corporates (15%), mortgage-backed securities (15%), U.S. government agency (11%), and other (2%). As of March 31, 2009, 49% of the fixed-income portfolio was rated 'AAA', with 'AA', 'A', and 'BBB' comprising 25%, 15%, and 6%, respectively. As of June 30, 2009, WRB's fixed-income portfolio had gross unrealized gains of \$303 million and gross unrealized losses of \$218 million.

WRB maintains a portion of its invested assets in a trading account focused on merger arbitrage. In the second quarter of 2009, WRB increased its trading account investment to \$623 million from \$193 million at year-end 2008. Merger arbitrage entails investing in securities of publicly traded companies that are the targets in announced tender offers and mergers. Usually, the change in value is four months or less.

In 2007, Berkley acquired two fixed-based operators, which each provide services to the general aviation market. As wholly owned investees, these investments flow through the revenue and expense lines of WRB's income statement. During the six months ended June 30, 2009, revenues associated with these investments totaled \$93 million, with corresponding expenses of \$77 million.

Liquidity is supported by a growing book of profitable business that generated net operating cash flows of \$1.5 billion in 2007, \$1.6 billion in 2006, and \$1.7 billion in 2005. However, because of reduced premium volume borne from disciplined underwriting amid declining prices, cash flow from operating activities continues to decline. However, after adjusting for \$425 million in transfers to its investment arbitrage account during the first six months of 2009, cash flow remains positive (\$416 million) as continued very strong operating performance offsets premium declines resulting from difficult market conditions. Cash and invested assets of \$395 million at the parent company as of year-end 2007 compares with \$89 million in interest expense recorded in 2007. The subsidiaries had dividend capacity of \$392 million as of year-end 2008 that is available without prior regulatory approval.

**Table 4 | [Download Table](#)**

### W.R. Berkley Corp.'s Operating Companies/Investment Statistics

–Six months  
ended June  
30–

–Year ended Dec. 31–

Invested assets	12,980	12,400	13,188	12,012	10,378.3
Year-over-year change (%)	4.7	(6.0)	9.8	15.7	24.4
Net investment income	117.456	533.48	672.7	586.1	404.0
Net investment yield (%)	1.8	4.2	5.3	5.2	4.3
Realized capital gains or losses	(80.12)	(356.9)	49.7	10.0	17.2
Total yield (%)	0.29	1.38	5.73	5.3	4.5
Net investment income to net premiums earned (%)	6.1	12.4	14.4	12.5	9.1
Shareholders' equity (including minority interest)	3,295.7	3,051.7	3,605.2	3,365.8	2,588.4
<b>Portfolio composition (% of invested assets)</b>					
Bonds (including mortgage-backed securities) (%)	80.1	78.1	76.3	76.2	81.8
Common stocks (%)	2.3	3.1	9.7	12.5	9.7
Other investments (%)	11.7	9.6	6.7	5.1	2.1
Cash and cash equivalents (%)	5.9	9.2	7.2	6.2	6.5

### Prospective

Standard & Poor's expects Berkley to maintain its actively managed investment portfolio, and the high-quality, fixed-income portfolio will support future obligations. The company will continue to manage and measure assets in terms of duration and diversification at the holding company level.

## Capitalization: Aggressive, Though Prudent, Capital Management, With Capital Declining In 2008 Before Bouncing Back This Year

Berkley is an aggressive, though prudent, manager of capital. Accordingly, management is willing to temporarily operate with capital that is below the rating level when it perceives opportunities. The combination of share repurchases and investment losses resulted in a temporary decline in capitalization to good but below the rating level as of year-end 2008 before earnings generation enabled capitalization to rebound to the strong level in mid-2009. Although capital is appropriate for the rating, especially when considering qualitative aspects such as minimal catastrophe exposure and relatively low policy limits and reinsurance recoverable exposure, the pursuit of rapid growth (35% in 2003 and 16% in 2004) in response to favorable pricing and underwriting resulted in historical capital levels below the rating category. We believe that, based on Berkley's historical performance, the company will continue to stress capital in the pursuit of profitable growth opportunities.

### Prospective

Standard & Poor's expects Berkley to continue managing capital adequacy at a low end for the rating level when favorable business opportunities present themselves. The company likely will do this while

capitalization will fall moderately below the rating level. The very strong level of earnings from its highly diversified, well-positioned subsidiaries offsets this weakness. But it is important to note that when WRB is stressing capital while pursuing high levels of growth, its capital will be less able to withstand volatility from an underwriting standpoint when it is booking materially larger volumes of new business.

## **Reserves**

Standard & Poor's believes that WRB's reserving practices are reasonable and have been enhanced through the addition of actuarial talent and enhanced processes in recent years, thereby reducing the chance of adverse development as reported in 2004-2006, which saw an aggregate \$509 million increase in prior-year reserves. Reserves for more recent years have developed favorably, as evidenced by favorable prior-year reserve development of \$196 million in 2008 and \$104 million in the first six months of 2009. WRB's relatively conservative inflation assumption of 6% on a four-year weighted duration reserve base adds some cushion to its reported reserve balance.

## **Reinsurance**

WRB's strategy of writing relatively low casualty policy limits relative to its GAAP equity base (\$3.3 billion as of June 2009) results in less reliance on reinsurance than many of its peers. The avoidance of property exposures further lessens the company's reinsurance requirements.

Reinsurance utilization, including servicing carrier business, was 10% in 2008, 9.4% in 2007, 8.6% in 2006, and 9.5% in 2005. This nonaffiliated reinsurance utilization ratio is near the lowest in the peer group. Reinsurance recoverables of \$943 million constitute 29% of GAAP equity.

## **Financial Flexibility: Good, But Strained By Tolerance For Somewhat High Financial Leverage**

Standard & Poor's views W.R. Berkley's financial flexibility as strong and appropriate for the rating category based on its ability to access the equity and debt markets and sustain very strong operating performance, notwithstanding recent investment losses. However, W.R. Berkley has been aggressive in managing its financial leverage. Although financial leverage declined to 32% as of June 2009 from 36% as of December 2005, W.R. Berkley is willing to temporarily manage its financial leverage to a somewhat aggressive level--up to 35%--when management believes profitable growth opportunities are available. As a result, any unexpected capital shortfall would, more so than for many peers, result in the potential need to access the more difficult equity markets rather than issue a debt or hybrid security. The company's tolerance for relatively high financial leverage and somewhat aggressive capitalization for the rating category is a reflection of its risk profile (low catastrophe exposed profile). However, Standard & Poor's views it as somewhat of a strain on financial flexibility, particularly if its operations were to suffer an unexpected, materially adverse event. This concern is offset somewhat by the possibility of increasing its currently low use of reinsurance, as well as a favorable long-term maturity schedule. Prospective maturities consist of \$1 million in 2009, \$150 million in 2010, \$2 million in 2012, \$200 million in 2013, \$200 million in 2015, \$150 million in 2019, \$76 million in 2022, \$12 million in 2023, \$7 million in 2035, and \$250 million in 2037, with \$250 million of subordinated debentures due in 2045. W.R. Berkley has no short-term debt in the form of commercial paper or outstanding bank lines.

Catastrophe exposures in terms of hurricanes and earthquakes are limited, given the company's casualty-focused business profile. A one-in-250-year net aggregate probable maximum loss was well less than 5% of GAAP equity as of December 2008.

Standard & Poor's expects financial leverage (debt plus preferred to total capital) to remain at less than

**Ratings Detail (As Of 24-Sep-2009)\*****Holding Company: [W.R. Berkley Corp.](#)**

Issuer Credit Rating	
<i>Local Currency</i>	BBB+/Stable/--
Preferred Stock (2 Issues)	BBB-
Senior Unsecured (7 Issues)	BBB+

**Operating Companies Covered By This Report****Acadia Insurance Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Counterparty Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Admiral Indemnity Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Admiral Insurance Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Berkley Insurance Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Berkley Regional Specialty Ins Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Carolina Casualty Insurance Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Clermont Ins Co.**

Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

**Continental Western Insurance Co.**

Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Firemen's Insurance Co. of Washington DC</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Gemini Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Great Divide Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Key Risk Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Midwest Employers Casualty Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Nautilus Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Preferred Employers Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Riverport Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>StarNet Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--

<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Union Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Union Standard Insurance Co.</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--
<b>Union Standard Lloyds</b>	
Financial Strength Rating	
<i>Local Currency</i>	A+/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A+/Stable/--

#### **Related Entities**

##### **W.R. Berkley Insurance (Europe) Ltd.**

Financial Strength Rating	
<i>Local Currency</i>	A/Stable/--
Issuer Credit Rating	
<i>Local Currency</i>	A/Stable/--

<b>Domicile</b>	Maine
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\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.